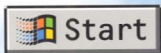


**ANNUAL REPORTS**

Microsoft Corporation 1995 (cop. 2)

**Foster Business Library  
University of Washington**



Microsoft Corporation 1995 Annual Report

**Business Administration Library  
University of Washington Libraries  
Box 353200  
Seattle, WA 98195-3200**

The journey of a thousand miles starts with a single step...  
or a single click.



In Windows 95, the path to discovery begins with the Start button. Press it and a powerful new era in computing unfolds. In this era, people will be more connected to information—and more connected to each other—than ever before.

For Microsoft, it represents another step and yet another beginning.

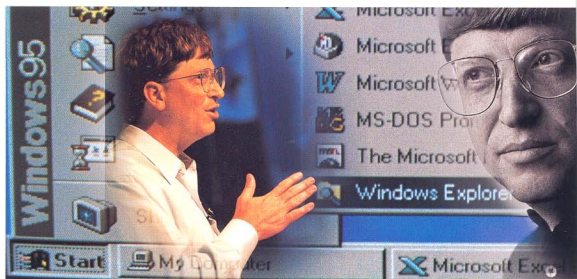
Twenty years ago, our company was founded on a simple, but profound idea: **A computer on every desk and in every home.**

In our pursuit of that vision, we have grown, changed, adapted, and reinvented ourselves—to meet the challenges of our competition, to take advantage of innovation, and to deliver on the dreams and demands of our customers.

This year, we're starting by introducing a new operating system. In the enterprise and in the home, we are extending the power and reach of the ever-changing personal computer, speeding its entry into the world of electronics communication and commerce, and laying the groundwork to carry computing to yet another generation.



# To Our **Shareholders**



**I**n 1975, Paul Allen and I founded the first microcomputer software company—Microsoft. Looking back over the last 20 years, our vision of a PC using great software as an empowering tool for everyone, coupled with our values of innovation, listening to customers, and taking a long-term approach in everything have been key to Microsoft's success. We have taken a number of risks over the years with products such as Microsoft® Excel, Word, MS-DOS®, Windows, Windows NT®, Macintosh® applications, and CD-ROM software. Looking forward, we are pursuing the same vision with the same values. We will continue to take risks with future updates to our current products and with new products targeted to customers ranging from the enterprise user to the home user.

[We are celebrating our 20th anniversary with the release of Microsoft Windows 95](#), the latest update to our popular Windows operating environment. More than just a technical achievement, Windows 95 and the related products, including Microsoft Office for Windows 95 and The Microsoft Network, represent a companywide accomplishment that required an extraordinary level of commitment and coordination—challenging our marketing, manufacturing, sales, and support organizations.

The largest launch in the history of the PC business, Windows 95 also launches the personal computer in a new role as a platform for the Internet and the world of interactive networks. The continued advances in hardware and communications technology will allow PC software to change the way we work, learn, and play. The merging of computing and communications technologies will give our customers access to a wide range of information and multimedia services. [We see more opportunities now for great software than at any time in our history.](#)

With the help of our partners and the great work of our employees, we have come a long way. This annual report offers a chance to review our recent accomplishments, as well as an opportunity to consider our future challenges.



William H. Gates

# Financial Highlights

(In millions, except earnings per share)	Year Ended June 30				
	1991	1992	1993	1994	1995
Net revenues	\$1,843	\$2,759	\$3,753	\$4,649	<b>\$5,937</b>
Net income	463	708	953	1,146	<b>1,453</b>
Earnings per share	0.82	1.20	1.57	1.88	<b>2.32</b>
Return on net revenues	25.1%	25.7%	25.4%	24.7%	<b>24.5%</b>
Cash and short-term investments	\$ 686	\$1,345	\$2,290	\$3,614	<b>\$4,750</b>
Total assets	1,644	2,640	3,805	5,363	<b>7,210</b>
Stockholders' equity	1,351	2,193	3,242	4,450	<b>5,333</b>

## Financial Results

Microsoft completed its 20th consecutive year of growth of revenues and profits, driven in large measure by the continuing success of the Microsoft Windows operating system and by the ongoing adoption of the Microsoft Office suite of applications by our customers around the world.

The Company recorded revenues of \$5.94 billion for the fiscal year 1995, a 28% increase over the \$4.65 billion reported last year. Net income totaled \$1.45 billion, and earnings per share were \$2.32.

Throughout much of the year, growth was paced by record results in the original equipment manufacturer (OEM) and international channels, particularly in Japan. Revenues also increased strongly for the Microsoft BackOffice™ family of products, which provides enterprisewide solutions for distributed computing.

# Report on Operations

T

his has been a watershed year for Microsoft. Our accomplishments of the past twelve months—including the development and release of Microsoft Windows 95, and our advances into online and Internet services—are laying the groundwork for new technologies that will bring expanded benefits to all of us in the years to come.

**Microsoft Windows 95** With the release of Microsoft Windows 95 in August 1995 the Company took a major step toward unlocking the potential of personal computing for our millions of customers worldwide. *Windows 95 is designed to make computing more powerful, easier, faster, and more fun—every day.* Millions of people are upgrading their systems to Windows 95 and applications for Windows 95, and many of them are connecting to MSN™, The Microsoft Network online service, as well as the Internet to expand their personal and professional horizons. Additionally, we expect the new operating system's ease of use will encourage many people to try computers for the first time, further expanding the presence of computers at home and at work. The combination of all these factors makes Microsoft Windows 95 truly an industrywide event, which will contribute to the future success of hundreds of other computer, peripheral, and software manufacturers.

**Microsoft Office** Due to tireless efforts from Microsoft developers, testers, marketers, and customer beta testers, Microsoft Office for Windows 95 was released the same day as Windows 95. This dual launch means that right away, customers were able to take advantage of the new operating system with a full suite of office application programs. With more than 12 million copies of previous versions distributed worldwide, Microsoft Office was already the most popular office suite on the market. Now, *Office for Windows 95 combines unprecedented ease of use, integration among programs, and 32-bit power*, with access to a wide range of business solutions that are available from more than 200 independent developers under the Microsoft Office compatible program.

**Microsoft BackOffice** While much of the media spotlight may have been on Windows 95 recently, our suite of products for the networked organization has also grown in functionality and popularity. Installations for Microsoft Windows NT Server have tripled over the past year, demonstrating the increasing adoption of the personal computer as a server platform. And such

companies as Saturn, Pennzoil, and AlliedSignal have joined the growing ranks of customers who are benefiting from distributed computing with our BackOffice integrated family of server software: Microsoft Windows NT, Microsoft SQL Server™, Microsoft SNA Server, Microsoft Systems Management Server, and Microsoft Mail Server.

**Microsoft Home** On the Home front, we continue to serve a large and growing consumer market with long-term best-sellers such as Microsoft Encarta, Encyclopedia and Flight Simulator; a completely redesigned version of Microsoft Money that combines unparalleled ease of use with electronic access to major banking institutions; and sizzling new titles—such as the Microsoft Fury™ action arcade game and Microsoft 3D Movie Maker for kids—that bring vibrant video and speedy performance to home users. Some of our Home products—such as Microsoft Bookshelf—are also venturing online as we begin to offer interactive information and entertainment via the MSN online service.

**Research** An important part of the overwhelming customer preference for Microsoft products is due to our long-standing emphasis on research and development. Advances such as those in the user interface, networked computing, and video and graphics capabilities evident in Windows 95 began in the minds of developers and researchers several years ago. Thanks to the efforts of thousands of dedicated research and development employees in 1995, combined with our increasing R&D budgets, it's clear that Microsoft is investing for the long term. That investment will help us produce the products and services for tomorrow that will make work and play part of a better future.

**The Microsoft brand** Where do you want to go today? In 1995, we asked this question to entrepreneurs in America, people with home computers in Europe, large-scale enterprises in Asia, growing businesses in the Pacific Rim, and millions more potential and current customers through our broad-reach advertising campaign. Our objective is to establish Microsoft as the company that leads the way in providing access to the new world of thinking and communicating. We launched this effort in response to the growing breadth of Microsoft's products and services that customers use at home, online, and in many other places besides the traditional office.

Stefenfeld, Paul Maritz, Nathan Myhrvold, Peter Higgins, Steve Ballmer



**Growth onsite and online** There are many other groups that have made substantial contributions to the growth and health of Microsoft this year. More than 17,800 employees located around the world have made monumental strides in developing, manufacturing, and delivering Microsoft products and services to our growing base of customers. From our experts who work with the worldwide community of developers who design applications and tools that run under Microsoft operating systems, to our product support experts who help customers work through problems large and small, to our sales personnel who strive to maintain long-term relationships with mass-market retail chains, to our publishing experts at Microsoft Press, to our "futurists" who are researching and developing next-generation operating systems and consumer platforms for electronic commerce, voice recognition, interactive television, and on-demand video access technology, we are all focused on helping our customers achieve what they want to do today and what they hope to do tomorrow.

**Microsoft management** Our fiscal year closed with the planned retirement of Mike Maples, formerly our Executive Vice President of Worldwide Products, along with resulting changes in our organization including the promotions of Peter Higgins and Nathan Myhrvold to Group Vice Presidents of Applications and Content; and Paul Maritz to Group Vice President of Platforms. For seven years, Mike Maples oversaw all Microsoft product development and marketing. True to our tradition of maintaining a long-term, consistent organization that combines both experience and insight to identify and capitalize on opportunities, Mike has not retired in the traditional sense. He continues to do work for Microsoft as a valued advisor and ambassador on strategic relationships and management initiatives.

**In summary...** This has been a successful year for Microsoft—our 20th consecutive year of growth. We continue to invest in technology and in the future, because we believe the industry continues to offer significant opportunities, as well as to present us with significant competitive challenges. We expect personal computer technology to expand its influence and effectiveness around the globe, and in the process, we hope to have a far-reaching impact that goes beyond computing to improve how our customers live and work.

We call it an advanced 32-bit operating system with preemptive multitasking, integrated network connectivity, and plug and play architecture designed to optimize hardware performance.

You'll call it easy.

# The new face of computing.

Early in the development of the new Microsoft Windows 95 operating system, our developers and managers gave themselves a major challenge: to find out what people wanted to do with computers, combine this with our knowledge of what technology can do for people, expand the vision to include what can be possible in the future, and then turn all of these complexities into tasks that are easy to do.

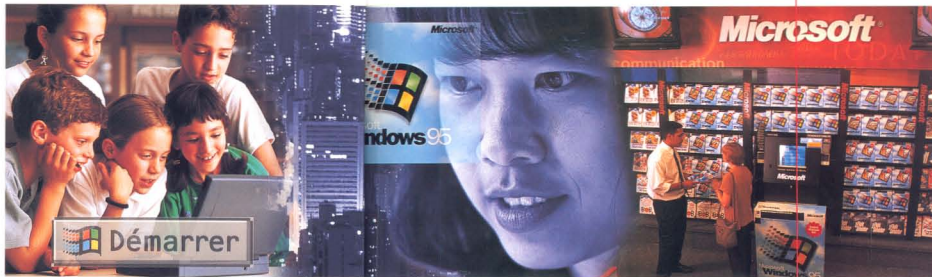
A heady set of objectives. But Microsoft people have always reached for—and tried to leap far beyond—such challenges. In this case, the Windows 95 launch set in motion a worldwide step into the future of computing.

What was once sometimes confusing to do on computers—such as keeping track of files and print jobs—is now even easier, more logical, and faster than ever before.

What was once a frightening experience—for example, installing a new modem and wrestling IRQs and COM ports into submission—is now automatic.

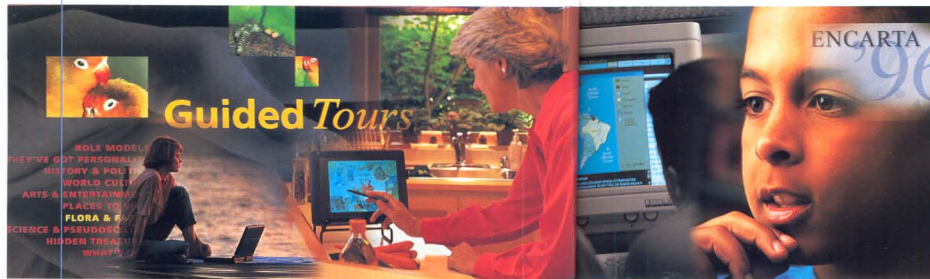
What was once impossible—such as having your computer multitask by performing two or more complex functions at the same time—now happens many times a day for everyone who uses Windows 95.

What was once simply imaginary is now both a possibility and reality, due to our investments in developing Windows 95 as a platform for future growth—in both the capabilities and the size of the computing industry. Whether our tens of millions of customers will be working in virtual offices, using Windows-based technology on their interactive TVs at home, or embarking on new careers and friendships on the information superhighway, Windows 95 will play an important part in their achievements this year, next year, and beyond.





# The new ways we'll be living.



We call it the dawn of a new era of education and entertainment built around the creation of consumer-oriented applications and forming the foundation of future interactive media.

You'll call it fun.

Today, most people think of television as a passive viewing device and the home computer as a tool for education or work: two distinct appliances. But not for long. Years ago, Microsoft developers, researchers, and futurists saw that the potential of home computing pointed to something far greater—the merging of televisions and computers into powerful integrated systems.

For the near term, we identified people's needs for today's home computers and created products to meet those needs. Today, our customers are getting more value out of their time with top-selling home computer programs like Microsoft Encarta Encyclopedia and Encarta World Atlas. They're cooking with Julia Child, enjoying the fruits of the vintner's labor with Wine Guide, playing

futuristic arcade action with FURY<sup>2</sup>, and benefiting from electronic banking with Money.

As for the long term, we've been working on powerful, new interfaces and other core elements of interactive media. These explorations will bring our customers into the exciting future of interactive television and electronic commerce.

With our aggressive development of these technologies and our investments in creative content development, we're poised to bring new forms of entertainment, education, and commerce into the home. The television and

home computer of today are blending into one powerful new medium with which our customers will have the choice to see, do, and understand anything they want any time of the day or night.

We call it an interactive transactional process system that allows for the electronic exchange of ideas and commercial transactions.

You'll call it smart money.

In the past year, Microsoft's customers and employees crossed a technology threshold that will forever change how people will learn, work, socialize, and shop. The new electronic commerce and communications technologies that we're developing will affect individuals and businesses of every type in ways far more pervasive than most people currently recognize.

We believe in stretching the limits of what technology can do for people in their daily lives. To that end, we're establishing a substantial presence within the new frontiers of technology that will help make life easier and more enjoyable for millions of people around the world.

In 1995, Microsoft customers received their first taste of these new types of technologies with the

introduction of MSN, The Microsoft Network online service. MSN presents significant opportunities for our company and our customers. MSN brings online benefits to business and mainstream PC users—not just the experienced users who have, up until now, populated the Internet and commercial online services. Whether they're looking for fun, for information, for help with their computers, or help for their businesses, MSN is delivering around the world, 24 hours a day, 7 days a week.

Along with developing the infrastructure for improved online communication to commercial

services and the Internet, we're also developing a groundbreaking framework for efficient and secure electronic commerce (that began with our electronic banking services in Microsoft Money). In addition, we're creating systems for the next generation of interactive televisions and personal computers.

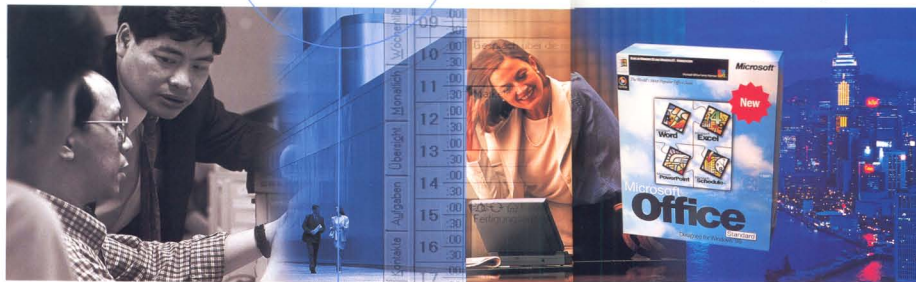
The Internet and interactive television are opening exciting possibilities for global, interactive communications. Microsoft's investments in products and services will turn those possibilities into tangible benefits.

The new ways we'll be  
buying  
selling &  
communicating.



msn.<sup>™</sup>  
The Microsoft Network

# The new ways we'll be working.



We call it an OLE-enabled suite of applications and a set of enterprisewide solutions that maximize productivity through integrated design.

You'll call it a great way to work.

There's a maxim in computing that says an operating system is only as successful as the programs people can run with it. Which is why Microsoft committed to releasing a new version of the world's most popular suite of office programs—Microsoft Office—on the same day that Windows 95 was launched.

Building on the success Office has brought to the 12 million people who currently use this popular suite of applications, *Office for Windows 95 helps people focus on the job at hand, rather than how to run a computer.* And while they may not be aware of the fact that these 32-bit programs are taking advantage of technological advancements in Windows 95 such as preemptive multitasking, multithreading, and enhanced OLE technology, our customers do know that they're

getting work done faster and that their work is more accurate and of higher quality. Office for Windows 95 has allowed our customers to embrace all of the advantages of new technology with none of the hard work.

Behind the scenes, our BackOffice suite of products has also vastly reduced the work required for organizations to build and maintain mission-critical distributed computing networks. Based on Microsoft Windows NT Server, BackOffice allows businesses large and small to instantly deliver information to the fingertips of anyone who needs it.

With Microsoft Office at the front end, making day-to-day work faster and more accurate, and BackOffice at the back end, seamlessly distributing data across local and global computer networks, Microsoft is helping our customers use technology to succeed today and to prepare for the challenges of tomorrow.

# Financial Results

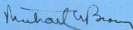
## A note to our shareholders:

We've summarized the financial section of our annual report this year to make it easier for you to read.

Comprehensive financial statements and footnotes with further details are now included in our Form 10-K, which was mailed to each shareholder along with a copy of this annual report. The annual report and the Form 10-K are also available through our Internet servers and on The Microsoft Network.

I encourage those of you with access to these electronic sources to check them out for yourself. Not only can you get ready access to financial and other information about Microsoft, but you can also use the content of this annual report as an interface to access a variety of additional financial information about our Company.

Thank you for your interest in Microsoft. We continue to be committed to outstanding products, solid operations, and long-term shareholder value. We're glad to have you, as a shareholder in Microsoft, with us on the journey.



Michael W. Brown  
Vice President, Finance  
Chief Financial Officer

## Income Statements

(In millions, except earnings per share)

	Year Ended June 30				
	1991	1992	1993	1994	1995
Net revenues	\$1,843	\$2,759	\$3,753	\$4,649	\$5,937
Operating expenses:					
Cost of revenues	362	467	633	763	877
Research and development	235	352	470	610	860
Sales and marketing	534	854	1,205	1,384	1,895
General and administrative	62	90	119	166	267
Total operating expenses	1,193	1,763	2,427	2,923	3,899
Operating income	650	996	1,326	1,726	2,038
Interest income—net	37	56	82	102	191
Noncontinuing items	—	—	—	(90)	(46)
Other expenses	(16)	(11)	(7)	(16)	(16)
Income before income taxes	671	1,041	1,401	1,722	2,167
Provision for income taxes	208	333	448	576	714
Net income	\$ 463	\$ 708	\$ 953	\$ 1,146	\$1,453
Earnings per share	\$ 0.82	\$ 1.20	\$ 1.57	\$ 1.88	\$ 2.32
Weighted average shares outstanding	563	588	606	610	627

**Net Revenues**



**Net Income**



**Earnings Per Share**



## Management's Discussion and Analysis

(Charts in millions)

### Results of Operations for 1993, 1994, and 1995

Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including operating system platforms for personal computers (PCs), workstations, and servers; business and consumer applications for productivity, reference, education, and entertainment; and development tools. Microsoft also sells personal computer books and input devices, and is engaged in the research and development of online and advanced technology software products.

### Net Revenues

The Company's net revenues grew 24% in the fiscal year ended June 30, 1994 and 28% in fiscal year 1995. Software license volume (as opposed to price) increases have been the principal factor in Microsoft's revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and corporate license programs, such as Microsoft Select, is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, e.g., Microsoft Office, are less than the sum of the prices for the individual programs included in these products when such programs are licensed separately.

**Product groups.** Microsoft has a platforms product group and an applications and content product group.

Platforms product group revenues were \$1.52 billion, \$1.83 billion, and \$2.36 billion in 1993, 1994, and 1995.

Principal personal systems products have been the MS-DOS and Microsoft Windows operating systems. MS-DOS is preinstalled on PCs by most OEMs, and revenues from such licenses increased steadily in both 1994 and 1995. Revenues from retail upgrade versions of MS-DOS decreased in both 1994 and 1995 after a strong increase in 1993 when the MS-DOS 6 Upgrade was released. There were no major upgrades of MS-DOS in 1994 or 1995. The Microsoft Windows operating system was an increasingly strong contributor to revenues as the number of new PCs preinstalled with Windows increased rapidly during the three-year period. Windows units licensed to new users were 15 million, 30 million, and 40 million in 1993, 1994, and 1995.

Business systems products offer an enterprise-wide distributed client/server environment based on the Microsoft Windows NT operating system and the server applications in the Microsoft BackOffice family of products. Revenues from these products increased strongly in 1994 and 1995.

Revenues from developer products increased steadily in all three years, as more independent software vendors, corporate developers, and solutions developers licensed tools to develop software for Windows and Windows NT.

Applications and content product group revenues were \$2.24 billion, \$2.82 billion, and \$3.58 billion in 1993, 1994, and 1995.

Increases in desktop applications revenues were led by strong sales of Microsoft Office. The Microsoft Office Standard product includes the Microsoft Excel spreadsheet, the Microsoft Word word processor, the Microsoft PowerPoint presentation graphics program, and a Microsoft Mail client-access license, while the Microsoft Office Professional version also includes the Microsoft Access database management system. Sales of stand-alone versions of

Platforms Revenues



Applications and Content Revenues



## Management's Discussion and Analysis (Cont.)

(Charts in millions)

Microsoft Excel and Microsoft Word decreased in 1994 and 1995 as the sales mix continued to shift to integrated product suites.

Microsoft Home, a broad range of consumer products, also showed continued growth. The Microsoft Home brand includes CD-ROM multimedia reference titles and software products for home and small office productivity, children's creativity, and entertainment. The Company also markets the Microsoft Mouse and Microsoft Natural Keyboard™. Mouse sales were flat during the three-year period, while the initial introduction of the keyboard increased revenues in 1995.

**Sales channels.** The Company distributes its products primarily through OEM licenses, corporate licenses, and retail packaged products. OEM channel revenues are license fees from original equipment manufacturers. Microsoft has three major geographic sales and marketing organizations: U.S. and Canada, Europe, and elsewhere in the world (Other International). Sales of corporate licenses and packaged products in these channels are primarily to distributors and resellers.

OEM channel revenues were \$731 million in 1993, \$1.18 billion in 1994, and \$1.65 billion in 1995. The primary source of OEM revenues is the

licensing of operating systems, particularly MS-DOS and Microsoft Windows. As such, OEM channel revenues are highly dependent on PC shipment volume.

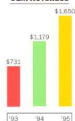
U.S. and Canada channel revenues were \$1.37 billion, \$1.58 billion, and \$1.88 billion in 1993, 1994, and 1995.

Revenues in Europe were \$1.26 billion, \$1.36 billion, and \$1.49 billion in 1993, 1994, and 1995. Growth rates have been lower in Europe than in other geographic areas due to general economic slowness, higher existing market shares, and a more dramatic shift to corporate licensing programs.

Other International channel revenues were \$392 million in 1993, \$532 million in 1994, and \$924 million in 1995. Growth rates continue to be strong due to customer acceptance of newly localized products, particularly in Japan, and early entrance into emerging markets.

The Company's operating results are affected by foreign exchange rates. Approximately 44%, 40%, and 37% of the Company's revenues were collected in foreign currencies during 1993, 1994, and 1995. Since much of the Company's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates on net income is less than on revenues.

**OEM Revenues**



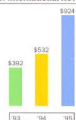
**U.S. and Canada Revenues**



**Europe Revenues**



**Other International Revenues**



## Management's Discussion and Analysis (Cont.)

(Chart in millions)

### Operating Expenses

Cost of revenues. As a percentage of revenues, cost of revenues was 16.9% in 1993, 16.4% in 1994, and 14.8% in 1995. The percentage decreased due to a greater proportion of licenses to OEMs and corporations, lower disk prices from vendors, and a higher proportion of CD-ROM versions. These factors were offset somewhat by increased sales of lower-margin products such as integrated suites and upgrades.

*Research and development.* The Company made substantial investments in R&D in 1994, and the rate of growth accelerated in 1995. Expense increases resulted primarily from development staff headcount growth and higher levels of third-party development costs in many areas, including development efforts for Windows 95 and The Microsoft Network. R&D costs also increased for business systems, consumer systems, desktop applications, and consumer products.

*Sales and marketing.* The increase in the absolute dollar amount of sales and marketing expense in 1995 was due primarily to increased product-specific marketing programs, a Microsoft brand advertising campaign, and continued expansion of Product Support Services. In 1994, sales and marketing expenses increased at a slower rate than revenues due to a concerted performance orientation at all sales sites.

*General and administrative.* Increases in general and administrative expenses in 1994 and 1995 were primarily attributable to higher legal costs and growth in the computer systems and the number of people necessary to support overall increases in the scope of the Company's operations.

### Nonoperating Items

Interest income, which was \$83 million, \$104 million, and \$193 million in 1993, 1994, and 1995, increased primarily as a result of a larger investment portfolio generated by cash from operations.

In the fourth quarter of 1995, Microsoft paid a \$46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger.

In the third quarter of 1994, the Company recorded a \$120 million charge to reflect the estimated impact of a jury verdict in the Stac Electronics patent litigation and related expenses. In June 1994, the Company reached an agreement with Stac to settle the litigation and adjusted its estimate accordingly, resulting in a credit of \$30 million in the fourth quarter and a net pretax charge of \$90 million for 1994.

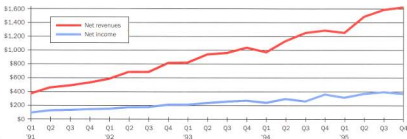
### Provision for Income Taxes

The effective tax rate increased from 32.0% in 1993 to 33.5% in 1994 and 33.0% in 1995 primarily because of an increase in the U.S. statutory income tax rate.

### Net Income

Net income as a percent of revenues decreased in 1995 due to increased relative research and development, sales and marketing, and general and administrative expenses, offset by the lower relative cost of revenues and the higher relative net non-operating income. The net income percentage decreased in 1994, primarily due to the patent litigation charge and increased research and development expenses, offset by the lower relative level of sales and marketing expenses.

**Quarterly Net Revenues and Net Income**



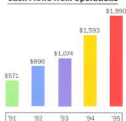


## Cash Flows Statements

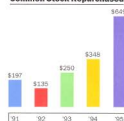
(In millions)

	Year Ended June 30				
	1991	1992	1993	1994	1995
<b>Cash flows from operations</b>					
Net income	\$463	\$ 708	\$ 953	\$1,146	<b>\$1,453</b>
Depreciation and amortization	76	112	151	237	<b>269</b>
Current liabilities	107	167	177	360	<b>419</b>
Accounts receivable	(65)	(33)	(121)	(146)	<b>(91)</b>
Inventories	8	(40)	(51)	23	<b>15</b>
Other current assets	(18)	(18)	(35)	(27)	<b>(75)</b>
Net cash from operations	571	896	1,074	1,593	<b>1,990</b>
<b>Cash flows from financing</b>					
Common stock issued	95	135	229	280	<b>332</b>
Common stock repurchased	(197)	(135)	(250)	(348)	<b>(649)</b>
Stock option income tax benefits	85	130	207	151	<b>179</b>
Net cash from financing	(17)	130	186	83	<b>(138)</b>
<b>Cash flows used for investments</b>					
Additions to property, plant, and equipment	(264)	(317)	(236)	(278)	<b>(495)</b>
Other assets	(40)	(41)	(17)	(64)	<b>(230)</b>
Short-term investments	(77)	(284)	(723)	(860)	<b>(651)</b>
Net cash used for investments	(381)	(642)	(976)	(1,202)	<b>(1,376)</b>
Net change in cash and equivalents	173	384	284	474	<b>476</b>
Effect of exchange rates on cash	(2)	(10)	(62)	(10)	<b>9</b>
Cash and equivalents, beginning of year	246	417	791	1,013	<b>1,477</b>
Cash and equivalents, end of year	417	791	1,013	1,477	<b>1,962</b>
Short-term investments	269	554	1,277	2,137	<b>2,788</b>
Cash and short-term investments	\$686	\$1,345	\$2,290	\$3,614	<b>\$4,750</b>

**Cash Flows from Operations**



**Common Stock Repurchased**

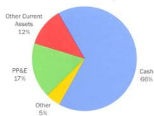


## Balance Sheets

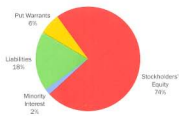
(In millions)

	June 30	
	1994	1995
<b>Assets</b>		
Current assets:		
Cash and short-term investments	\$ 3,614	<b>\$4,750</b>
Accounts receivable—net of allowances of \$92 and \$139	475	<b>581</b>
Inventories	102	<b>88</b>
Other	121	<b>201</b>
Total current assets	4,312	<b>5,620</b>
Property, plant, and equipment—net	930	<b>1,192</b>
Other assets	121	<b>398</b>
Total assets	\$5,363	<b>\$7,210</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 324	<b>\$ 563</b>
Accrued compensation	96	<b>130</b>
Income taxes payable	305	<b>410</b>
Other	188	<b>244</b>
Total current liabilities	913	<b>1,347</b>
Minority interest	—	<b>125</b>
Put warrants	—	<b>405</b>
Stockholders' equity:		
Common stock and paid-in capital—shares authorized 2,000; issued and outstanding 581 and 588	1,500	<b>2,005</b>
Retained earnings	2,950	<b>3,328</b>
Total stockholders' equity	4,450	<b>5,333</b>
Total liabilities and stockholders' equity	\$5,363	<b>\$7,210</b>

**Assets—1995**



**Liabilities and Stockholders' Equity—1995**



## Management's Discussion and Analysis (Cont.)

(Charts in millions)

### Financial Condition

The Company's cash and short-term investments totaled \$4.75 billion at June 30, 1995. The portfolio is diversified among security types, industries, and individual issuers. The Company's investments are investment grade and liquid. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The Company's portfolio is invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs.

Microsoft has no material long-term debt. The Company has \$70 million of standby multicurrency lines of credit that support foreign currency hedging and international cash management.

Stockholders' equity at June 30, 1995 exceeded \$5.3 billion.

Cash generated from operations has been sufficient historically to fund the Company's investment in research and development activities and facilities expansion. As the Company grows, investments will continue in research and development in existing and advanced areas of technology. The Company's cash will also be used to acquire technology and to fund ventures and other strategic opportunities. Additions to property, plant, and equipment are expected to continue, including facilities and computer systems for research and development, sales and marketing, product support, and administrative staff. For example, on June 30, 1995, commitments related to the construction of new buildings approximated \$150 million.

The exercise of stock options by employees provides additional cash. These proceeds have been used in the Company's open market stock repurchase program through which Microsoft provides shares for stock option and stock purchase plans. This program will continue in 1996.

During 1995, to enhance its stock repurchase program, Microsoft sold equity put warrants to independent third parties. These put warrants entitle the holders to sell shares of Microsoft common stock to the Company on certain dates at specified prices.

Also during 1995, a subsidiary of Tele-Communications, Inc. (TCI) purchased a 20% minority interest in the newly formed Microsoft Online Services Partnership. TCI contributed \$125 million of TCI common stock, and Microsoft contributed the business assets of its online service, The Microsoft Network, which was in development.

Management believes existing cash and short-term investments together with funds generated from operations will be sufficient to meet operating requirements in 1996. The Company's cash and short-term investments are also managed to be available for strategic investment opportunities or other potential large-scale cash needs that may arise in pursuit of the Company's long-term strategies.

Microsoft shareholders have also authorized the issuance of up to 100 million shares of preferred stock, which may be used for any proper corporate purpose.

Microsoft has not paid cash dividends on its common stock.

**Research and Development Spending**



**Sales and Marketing Spending**



## Outstanding Common Shares and Options

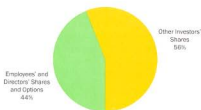
(in millions, except per share amounts)

	June 30				
	1993	Change	1994	Change	1995
<b>Outstanding common shares and options</b>					
Directors' and officers' common shares	260	(21)	239	(7)	<b>232</b>
Employees' and directors' net vested and unvested stock options	44	(3)	41	9	<b>50</b>
Employees' and directors' shares and options	304	(24)	280	2	<b>282</b>
Other investors' common shares	305	37	342	14	<b>356</b>
Total	609	13	622	16	<b>638</b>
Nasdaq closing price per share	\$ 44		\$51-5/8		<b>\$ 90-3/8</b>

### Computed values

Directors' and officers' common shares	\$11,465	\$ 845	\$12,310	\$ 8,653	<b>\$20,963</b>
Employees' and directors' net vested and unvested stock options	1,923	175	2,098	2,431	<b>4,529</b>
Employees' and directors' shares and options	13,388	1,020	14,408	11,084	<b>25,492</b>
Other investors' common shares	13,416	4,259	17,675	14,508	<b>32,183</b>
Total	\$26,804	\$5,279	\$32,083	\$25,592	<b>\$ 57,675</b>

**Stakeholdings—1995**



At Microsoft, every employee is eligible to become a stockholder in the Company through the Company's employee stock purchase and stock option plans. Management believes stock options make a major contribution to the success of Microsoft by aligning employee interests with those of other stockholders.

Stock options are widely used today, and many of the Company's competitors have similar programs.

During the last several years, there has been considerable debate about stock options and how they should be shown in financial statements. The above statement of outstanding common shares and options shows common shares and net stock options

and changes in their computed values based on quoted prices for the Company's stock. We believe it helps provide an understanding of the Company's equity, its equity holders, and the value or possible value of their vested and unvested holdings.

In this statement, common shares are those outstanding. Net vested and unvested options are calculated in a manner similar to the treasury stock method used in calculating earnings per share. Computed values are calculated based on the closing price of the Company's common stock on the Nasdaq Stock Market on the dates indicated.

## Outlook: Issues and Uncertainties

Microsoft does not provide forecasts of potential future financial performance. While management of Microsoft is optimistic about the Company's long-term prospects, the following issues and uncertainties, among others, should be considered in evaluating its growth outlook.

**Rapid technological change.** The personal computer software industry is characterized by rapid technological change and uncertainty as to the impact of emerging areas such as the Internet and online services, the information highway, networked collaboration products, and electronic commerce.

**Long-term investment cycle.** Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. The Company's plans for 1996 include significant investments in software research and development and related product opportunities from which significant revenues are not anticipated for a number of years. Management expects total spending for research and development in 1996 to increase over spending in 1995.

**Customer acceptance.** While the Company performs extensive usability and beta testing of new products, user acceptance and corporate penetration rates ultimately dictate the success of development and marketing efforts of products such as Windows 95, Microsoft Office for Windows 95, or the Microsoft BackOffice family of products.

**Product ship schedules.** Delays in the release of new products can cause operational inefficiencies that impact manufacturing and distribution logistics, independent software vendor (ISV) and OEM relationships, and telephone support staffing.

**Prices.** Future prices the Company is able to obtain for its products may decrease from historical levels depending on competitive market or cost factors. Prices of software in Europe are generally higher than in the U.S. to cover localization costs and higher costs of distribution. Such price uplifts could erode in the future.

**Integrated suites.** The price of integrated suites, such as Microsoft Office, is less than the sum of the prices for the individual programs included in this product when such programs are licensed separately. Revenues from Microsoft Office may continue to increase as a percentage of total revenues.

**Saturation.** Product upgrades, enabling users to upgrade from earlier versions of the Company's products or from competitors' products, have lower prices and margins than new products. As the desktop applications market becomes saturated, the sales mix shifts from standard products to upgrade products. This trend is expected to continue.

**Channel mix.** Average revenue per license is lower from OEM licenses than from retail versions, reflecting the relatively lower direct costs of operations in the OEM channel. An increasingly higher percentage of revenues was achieved through the OEM channel during 1994 and 1995.

**Corporate licenses.** Average revenue per unit from corporate license programs is lower than average revenue per unit from retail versions shipped through the finished goods channels. Unit sales under corporate licensing programs may continue to increase.

**Cost of revenues.** Although cost of revenues as a percentage of net revenues decreased in 1994 and 1995, it varies with channel mix and product mix within channels. Changes in channel and product mix, including the potential retail upgrade cycle of Windows 95, may increase cost of revenues as a percentage of net revenues in 1996.

**Sales and marketing and support investments.** The Company's plans for 1996 include continued investments in its sales and marketing and support groups. Microsoft brand advertising is also expected to increase.

**Foreign exchange.** A large percentage of the Company's sales and costs of manufacturing and marketing are transacted in local currencies. As a result, the Company's international results of operations are subject to foreign exchange rate fluctuations.

**Intellectual property rights.** Microsoft diligently defends its intellectual property rights, but unlicensed copying of software represents a loss of revenues to the Company. While this adversely affects U.S. revenues, revenue loss is even more significant outside of the U.S., particularly in certain countries where laws are less protective of intellectual property rights. Throughout the world, Microsoft actively educates consumers on the benefits of licensing genuine products and educates lawmakers on the advantages of a business climate where intellectual property rights are protected. There can be no assurance that continued efforts will affect revenues positively.

**Future growth rates.** If a substantial number of users upgrade to Windows 95, revenue growth rates in the initial shipping quarters of 1996 could be at relatively high levels. Revenue growth rates in the comparable quarters of 1997 may not approach such levels. As discussed above, operating expenses are expected to increase in 1996. Because of the fixed nature of a significant portion of such expenses, coupled with the possibility of slower revenue growth, operating margins in 1997 may decrease from those in 1996.

**Litigation.** Litigation regarding intellectual property rights, patents, and copyrights is increasing in the PC software industry. In addition, there are government regulation and investigation risks along with other general corporate legal risks.

## Microsoft Corporation Directors and Officers

### Directors

William H. Gates  
Paul G. Allen

Richard A. Hackborn  
David F. Marquardt  
Robert D. O'Brien  
Wm. G. Reed, Jr.  
Jon A. Shirley

Chairman of the Board and Chief Executive Officer, Microsoft Corporation  
Founder, Asymetrix Corp.; Chairman, Starwave Corp.; Interval Research, Corp.;  
Ticketmaster Holdings Group  
Executive Vice President, Hewlett-Packard Company (retired)  
General Partner, Technology Venture Investors  
Chairman of the Board, PACCAR, Inc. (retired)  
Chairman, Simpson Investment Company  
President and Chief Operating Officer, Microsoft Corporation (retired)

### Officers

William H. Gates  
Steven A. Ballmer  
Robert J. Herbold  
Frank M. (Pete) Higgins  
Paul A. Maritz  
Nathan P. Myhrvold  
James E. Allchin  
Roger Heinen  
Joachim Kempin  
Craig Mundie  
William H. Neukom  
Jeffrey S. Raikes  
Brad A. Silverberg  
Patricia Q. Stonesifer  
Bernard P. Vergnes  
Orlando Ayala  
Michael W. Brown  
Raymond A. Emery  
Richard Fade  
Michel Lacombe  
Jonathan D. Lazarus  
Robert L. McDowell  
Mike Murray  
John F. Neilson  
Chris Peters  
Richard Rashid  
Darryl E. Rubin  
Stephen A. Schiro  
Rolf Skoglund  
Charles Stevens  
Deborah Willingham  
John G. Connors  
Christopher R. Gibbons  
Gregory B. Maffei

Chairman of the Board; Chief Executive Officer  
Executive Vice President, Worldwide Sales and Support  
Executive Vice President; Chief Operating Officer  
Group Vice President, Applications and Content Group  
Group Vice President, Platforms Group  
Group Vice President, Applications and Content Group  
Senior Vice President, Business Systems Division  
Senior Vice President, Developer Division  
Senior Vice President, Worldwide OEM Sales  
Senior Vice President, Consumer Systems Division  
Senior Vice President, Law and Corporate Affairs; Secretary  
Senior Vice President, North America  
Senior Vice President, Personal Systems Division  
Senior Vice President, Consumer Division  
Senior Vice President, Microsoft; President, Microsoft Europe  
Vice President, Inter-Continental  
Vice President, Finance; Chief Financial Officer  
Vice President, Operations  
Vice President, Desktop Applications Division  
Vice President, Europe  
Vice President, Strategic Relations  
Vice President, Strategic Enterprise Services  
Vice President, Human Resources and Administration  
Vice President, Organization Customer Unit  
Vice President, Office Product Unit  
Vice President, Research  
Vice President, Software Strategy  
Vice President, End-User Customer Unit  
Vice President, Organization Customer Unit, Europe  
Vice President, Far East  
Vice President, Product Support Services  
Corporate Controller  
Chief Information Officer  
Treasurer

## An Invitation to Shareholders

As a Microsoft shareholder, you're invited to contact us for a variety of shareholder services or to request more information about Microsoft. Here are some suggestions on how to reach us:

### Account Questions

Our transfer agent, First Interstate Bank, can help you with a variety of shareholder-related services, including:

- Change of address
- Lost stock certificates
- Transfer of stock to another person
- Additional administrative services

You can call First Interstate toll-free at (800) 522-6645. You can also write them at:

First Interstate Bank  
Recordkeeping Services  
P.O. Box 590  
Ridgefield Park, NJ 07660-0590

Shareholders of record who receive more than one copy of this annual report can contact First Interstate Bank and arrange to have their accounts consolidated. Shareholders who own Microsoft stock through a brokerage can contact their broker to request consolidation of their accounts.

### Investor Relations

You can contact Microsoft's Investor Relations group any time to order financial documents such as this annual report and the Form 10-K. Call us toll-free at (800) 285-7772. (Outside the United States, call (206) 936-4400.) Or send a fax to (206) 936-8000. We can be contacted during west coast business hours to answer investment-oriented questions about Microsoft. In addition, you can write us at:

Investor Relations Department  
Microsoft Corporation  
One Microsoft Way  
Redmond, Washington 98052-6399

Or send us an electronic mail at [msft@microsoft.com](mailto:msft@microsoft.com)

### Annual Meeting

Microsoft shareholders are invited to attend our annual meeting, which will be held on Friday, October 27, 1995, at 8:00 A.M., at the Hyatt Regency Bellevue at Bellevue Place, 900 Bellevue Way NE, Bellevue, Washington.

### Common Stock

Microsoft common stock is traded over the counter on the Nasdaq Stock Market (ticker symbol: MSFT).

### Independent Auditors

Deloitte & Touche LLP, Seattle, Washington

---

### Get Financial Information Online

More and more shareholders are accessing financial information electronically as a way to get up-to-date information quickly. Anyone with access to the Internet or to The Microsoft Network can view an electronic copy of this annual report along with other financial materials.

- World Wide Web users can find us on the Microsoft home page, located at <http://www.microsoft.com>
- Microsoft Network users can reach our site in the Microsoft area under the name **MSFT**

## Offices

### Corporate Headquarters

Microsoft Corporation  
One Microsoft Way  
Redmond, WA 98052-6399  
USA

### European Headquarters

Microsoft Europe  
Tour Pacific  
Cedex 77  
92977 Paris-La Defense  
FRANCE

### Latin American Headquarters

Microsoft Latin America  
Cambridge Executive Center  
899 West Cypress Creek Road  
Suite #400  
Ft. Lauderdale, FL 33309  
USA

### Manufacturing

Microsoft Corporation  
Manufacturing and Distribution Center  
at Canyon Park  
21919 20th Avenue SE  
Bothell, WA 98021  
USA

Microsoft Manufacturing B.V.  
Blackthorn Road  
Sandyford Industrial Estates  
Dublin 18  
IRELAND

Microsoft Puerto Rico, Inc.  
Humacao Industrial Park  
Road 3, KM 77.0 vici 77.8  
Humacao 00661  
PUERTO RICO

### International Operations

Microsoft de Argentina S.A.  
Buenos Aires ARGENTINA

Microsoft PTY Ltd.  
Sydney AUSTRALIA

Microsoft Gesellschaft m.b.H.  
Vienna AUSTRIA

Microsoft N.V.  
Brussels BELGIUM

Microsoft Informatica Ltda.  
Sao Paulo BRAZIL

Microsoft Canada Inc.  
Toronto CANADA

Softimage Inc.  
Montreal CANADA

Microsoft Chile S.A.  
Santiago CHILE

Branch of Microsoft Colombia Inc.  
Bogota COLOMBIA

Microsoft De Centroamérica S.A.  
San Jose COSTA RICA

Microsoft S.R.O.  
Prague CZECH REPUBLIC

Microsoft Danmark ApS  
Hedenhusene DENMARK

Corporación Microsoft del Ecuador  
Quito ECUADOR

Microsoft Oy  
Helsinki FINLAND

Microsoft France S.A.R.L.  
Paris FRANCE

Softimage S.A.R.L.  
Paris FRANCE

Microsoft G.m.b.H.  
Munich GERMANY

Microsoft Hellas S.A.  
Athens GREECE

Microsoft Hong Kong Ltd.  
HONG KONG

Microsoft Kft  
Budapest HUNGARY

Microsoft Corporation (India)  
Private Ltd.  
New Delhi INDIA

Microsoft Israel Ltd.  
Tel Aviv ISRAEL

Microsoft S.p.A.  
Milan ITALY

Softimage S.R.L.  
Milan ITALY

Microsoft Company Ltd.  
Tokyo JAPAN

Microsoft CH  
Seoul KOREA

Microsoft (Malaysia) Sdn. Bhd.  
Kuala Lumpur MALAYSIA

Microsoft México S.A. de C.V.  
Mexico City MEXICO

Microsoft Maroc S.A.R.L.  
Casablanca MOROCCO

Microsoft B.V.  
Hoofddorp THE NETHERLANDS

Microsoft New Zealand Ltd.  
Auckland NEW ZEALAND

Microsoft Norge AS  
Oslo NORWAY

Microsoft Corporation Beijing  
Representative Office  
Beijing, China  
THE PEOPLE'S REPUBLIC OF CHINA

Microsoft Perú S.A.  
Lima PERU

Microsoft Philippines Inc.  
Manila THE PHILIPPINES

Microsoft SP. Z.O.O.  
Warsaw POLAND

Microsoft Software Para  
Microcomputadores Ltda.  
Lisbon PORTUGAL

Microsoft Caribbean Inc.  
Guaynabo PUERTO RICO

Microsoft Taiwan Corporation  
Taipei, Taiwan  
REPUBLIC OF CHINA

Microsoft A.O.  
Moscow RUSSIA

Microsoft Singapore Pte. Ltd.  
SINGAPORE

Microsoft S.R.O.  
Bratislava SLOVAK REPUBLIC

Microsoft D.O.O. Ljubljana  
Ljubljana SLOVENIA

Microsoft (S.A.) (Proprietary) Ltd.  
Johannesburg SOUTH AFRICA

Microsoft Iberica S.R.L.  
Madrid SPAIN

Microsoft Aktiebolag  
Stockholm SWEDEN

Microsoft A.G.  
Zurich SWITZERLAND

Microsoft (Thailand) Limited  
Bangkok THAILAND

Microsoft Bilgişayar Yazılım Hizmetleri  
Limited Şirketi  
Istanbul TURKEY

Microsoft Corporation (Dubai Branch)  
Dubai UNITED ARAB EMIRATES

Microsoft Ltd.  
Berkshire UNITED KINGDOM

Softimage (U.K.) Ltd.  
London UNITED KINGDOM

Corporación MS 90 de Venezuela S.A.  
Caracas VENEZUELA

For a list of complete subsidiary addresses, please  
consult Microsoft Investor Relations.





© 1995 Microsoft Corporation. All rights reserved.

Companies, names, and/or data used in screens are fictitious unless otherwise noted.

Microsoft, BackOffice, the BackOffice logo, Backstage, Encarta, MS-DOS, MSN, Natural Keyboard, the Office Compatible logo, PowerPoint, Windows, the Windows logo, Windows NT, the Windows NT logo, and Where do you want to go today? are either registered trademarks or trademarks of Microsoft Corporation in the United States and/or other countries. Macintosh is a registered trademark of Apple Computer, Inc. Flight Simulator is a registered trademark of Bruce A. Artwick.

 recycled paper

[illegible]

WHERE DO YOU WANT TO GO TODAY?